Federal spending: changing trends

FEDERAL SPENDING: CHANGING TRENDS

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ISSUE DEFINITION

Since 1970, total federal government expenditures have increased from $14,016 million to about $172,000 million when measured on a National Accounts basis, a compound annual growth rate of 10.5%. To put this in perspective, federal expenditures, which accounted for 16% of Gross Domestic Product (GDP) in early 1970, accounted for 21.5% of GDP as of the fourth quarter of 1995. Total federal spending is now approaching its pre-recessionary levels, when measured against GDP.

The longer-term trend in spending originated many decades ago. This paper is concerned with only the more recent growth and explores not so much the aggregate level of expenditures as changes in the various components of spending. It will examine those components which account for total expenditure growth and explain why they do so.

BACKGROUND AND ANALYSIS

A. Spending Trends

Figure 1, page 3, presents one approach to federal government expenditures, using national accounts data. It outlines the major components of expenditures: transfers to persons, transfers to business, transfers to provinces and interest on debt. Expenditures on goods and services represent the consumption element of government spending, their effect on the economy being equivalent to that of private sector spending. This component has been remarkably constant as a proportion of GDP, staying at about the 5% level between 1970 and 1985. **Since 1985, however, it has decreased so that it now stands closer to 4% of GDP**. It is therefore not

* The original version of this Current Issue Review was published in January 1987; the paper has been regularly updated since that time.

presented in the figure. Its importance relative to the federal budget has been steadily declining. **In 1970, expenditures on goods and services accounted for 30.5% of federal spending, whereas they accounted for under 19% in 1995.**

Growth in government spending has occurred primarily in the area of transfer payments. Figure 1 presents the major components of these transfers.

Transfers to persons have been traditionally the largest component of these expenditures. In 1970, they amounted to 4.5% of GDP. Transfers to persons increased dramatically from the third quarter of 1989, when they amounted to only 5.8% of GDP, to the second quarter of 1993, when they equalled 8.1% of GDP, a record level. Most of this increase was due to higher UI benefits. **Since then, there has been a substantial decline as the economy has improved and transfers to persons are now at about 7% of GDP.**

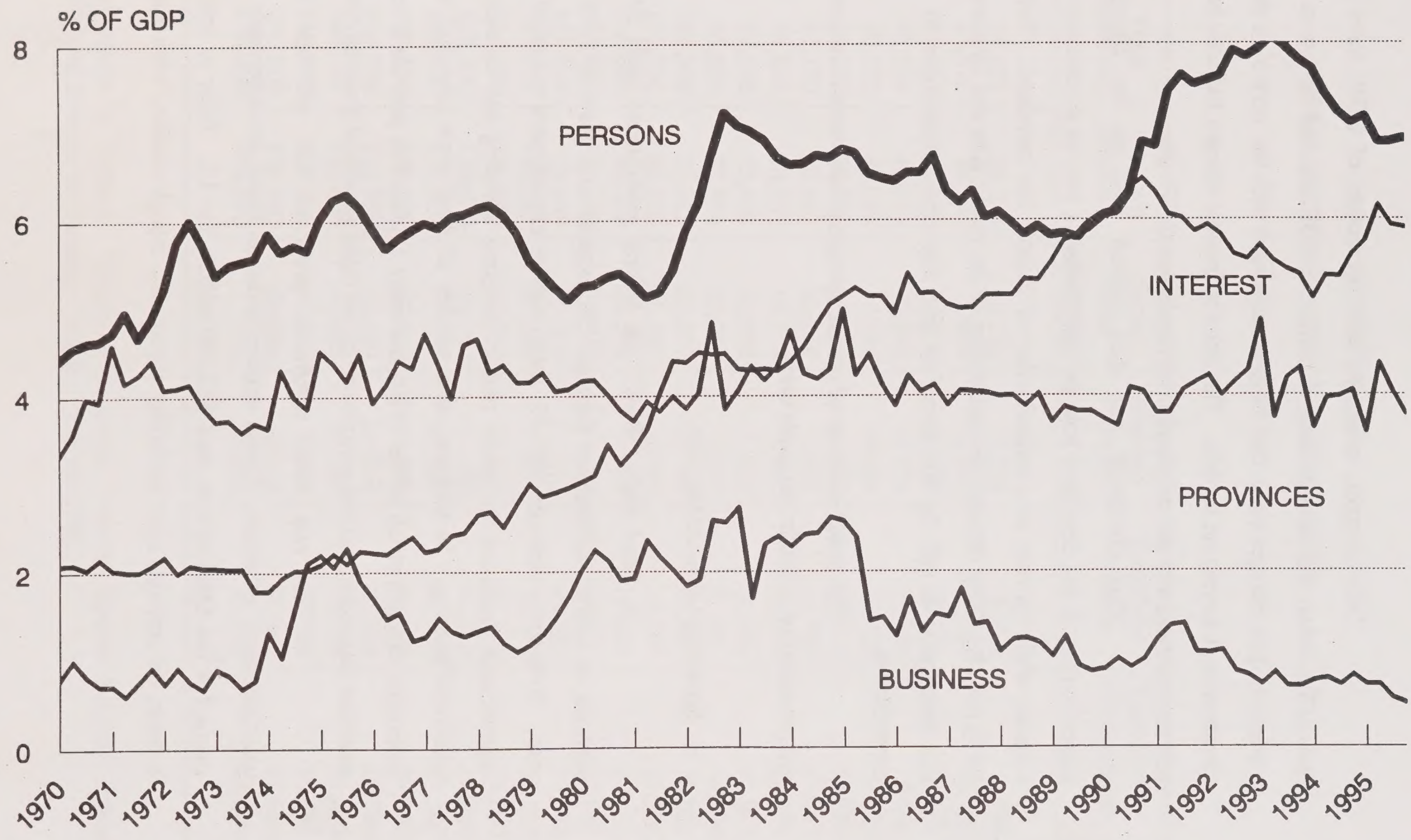
Transfers to business (capital assistance and subsidies) now equal less than 1% of GDP, averaging 0.62% in 1995. In 1970, business transfers stood at 0.8% of GDP. They peaked during the period 1981 to mid 1985, averaging about 2.3% of GDP. These transfers have been declining almost continuously since then. The first part of 1991 saw a marked rise in this component, which has now been reversed. Most of these transfers go to Crown corporations, the CBC, CMHC, etc.

Transfers to provinces are today only a slightly higher percentage of GDP than they were in 1970. The average over the entire period is a little higher than indicated by these end points.

The final major component of federal spending relates to the interest paid on the public debt. In 1970 these debt service charges amounted to 2.1% of GDP. **Now they are closer to 6% of GDP and equal 27% of all federal spending.** The third quarter of 1989 marked a watershed with debt charges exceeding, for the first time since 1970, transfers to persons. This was reversed in the last quarter of 1990 but rising interest rates in 1994 changed the trend once again. Debt charges are, in a sense, the deferred tax that the present generation of taxpayers must pay for the expenditures of previous generations. They are directly a function of two variables: the interest rate paid on the debt outstanding, and the size of that debt. The size of the debt is essentially a sum of past deficits. Thus the debt in any period can be viewed as a stock of deferred taxes and debt charges that have become the present generation's responsibility.

FEDERAL SPENDING

TRANSFERS AS A % OF GDP



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Most recent data are for 4th quarter, 1995

Debt charges, measured as a percentage of GDP, have been growing since the mid-1970s, when the ratio of total liabilities to GDP reached its lowest point. The very rapid growth in debt charges since late 1982 is associated with the very high real interest rates that the government is paying on its debt. The trend in interest charges has now been reversed with falling real interest rates and the stabilization of the debt to GDP ratio.

This discussion has shed limited light on the changing nature of federal expenditures. It has described how the government's role as a consumer has remained relatively constant while its role as a redistributior of income has increased. Further, past programs are being paid for today through the mechanism of the public debt and its associated debt charges. But this description is still far too broad to give any real indication as to what is happening with expenditures.

The dollar amounts of certain spending components are presented in Table 1. These are presented on a Public Accounts basis.

B. Spending on Social Services

In fiscal year 1986-87, the federal government spent $41,711 million on social services, as defined by Statistics Canada. The expenditures grew by 3.7% over the previous fiscal year. Over three years to 1986-87, social service expenditures increased by almost 20%. These expenditures constitute the major part of program spending and as such are a good subject for additional scrutiny. In addition, as a number of them were (and still are) subject to automatic indexation through much of the 1970s and early 1980s, they provide a convenient area to test the assertion that indexation has contributed to the rapid growth of government expenditures.

The two most significant programs are old age security payments and unemployment insurance. **Gross expenditures on these are currently in the $21,200 million range for the OAS system and $13,500 million for UI.** Prior to reform of the Child Benefit System, the amounts spent on family allowances, though smaller, were also important.

TABLE 1

SOME FEDERAL SPENDING STATISTICS

(in million dollars)

Year (ending 31 March)	Total Spending	Program Spending	Gross Debt Charges	National Defence	Transfers: Persons	Transfers: Governments
1975	31,472	28,234	3,238	2,526	8,099	5,956
1976	37,876	33,906	3,970	2,966	9,766	6,953
1977	41,187	36,479	4,708	3,373	10,466	8,492
1978	45,534	40,003	5,531	3,776	11,743	8,635
1979	50,073	43,049	7,024	4,096	12,735	9,688
1980	54,012	45,518	8,494	4,377	12,711	10,735
1981	63,170	52,512	10,658	5,063	14,799	11,467
1982	75,848	60,734	15,114	5,989	17,191	12,959
1983	89,396	72,493	16,903	6,938	22,980	14,021
1984	96,891	78,814	18,077	7,843	23,901	16,894
1985	109,568	87,113	22,455	8,762	25,346	18,325
1986	111,516	86,075	25,441	9,094	26,597	18,534
1987	116,664	90,006	26,658	9,993	28,009	19,192
1988	125,813	96,785	29,028	10,769	29,009	20,053
1989	133,018	99,849	33,169	11,026	30,392	21,588
1990	142,703	103,883	38,820	11,453	32,209	22,772
1991	151,250	108,300	42,950	12,145	35,775	23,300
1992	155,500	114,000	41,500	12,150	41,000	24,050
1993	161,900	122,500	39,400	11,200	42,100	27,100
1994	**158,000**	**120,000**	**38,000**	**10,900**	**39,300**	27,100
1995	**160,700**	**118,700**	**43,000**	**10,700**	**35,300**	**26,700**
1996	164,700	**113,800**	**47,000**	**10,300**	**34,700**	**26,600**
1997	**160,800**	**109,000**	**47,800**	**9,800**	**35,700**	**23,000**
1998	**156,800**	**106,000**	**49,000**	**9,100**	**37,000**	**20,600**
1999	**155,000**	**105,500**	N/A	**8,500**	**38,300**	**20,200**

Source: Department of Finance, "Quarterly Economic Review, Special Report," March 1992; and Minister of Finance, "Budget," **March 1996**.

Federal spending on social security in 1988 amounted to $45,335 million, compared to $4,497 million in 1970. Spending grew 14.6% faster than average in Newfoundland, while it grew about 14% less than average in Saskatchewan. In Ontario, spending increased 10% less than the national average. These provincial variations are due to differences in population growth, income growth and demographic change.

1. Old Age Security and Related Programs

The Old Age Security (OAS) provides a universal taxable benefit to anyone over the age of 65 who meets certain residence requirements. This benefit is indexed quarterly to changes in the Consumer Price Index. It has been indexed, off and on, to the rate of inflation since 1971. The OAS is complemented by two other programs for the elderly: Guaranteed Income Supplement (GIS) and the Spouse's Allowance (SPA). These programs put to rest the myth that selectivity necessarily reduces program cost. Although the system has become more selective, it has also become more generous and thus more expensive.

After 1952, the system of old age pensions was completely universal; however, with the introduction of the GIS, it is becoming increasingly selective. This becomes clear if we consider the relationship between the maximum OAS and GIS rates. In 1971 the GIS maximum was 69% of the OAS payment. By 1987 it reached 119% of the OAS rate, where it remains today. Put another way, the OAS payments have stayed relatively constant since 1971; when measured in real dollars, they have increased by only 13%, while the maximum GIS rate has more than doubled.

From 1970 to 1988, total net payments for Old Age Security increased by a factor of approximately 5.7 while those for the Guaranteed Income Supplement increased by a factor of 12.5. The increase in total outlays is a function of two variables: annual payments per recipient and the number of recipients. It is clear that the major determinant of total OAS payments is the growth in recipient population. If we had kept the real value of benefits constant at 1970 levels, the total OAS bill in 1988 would have been $9,373 million rather than $10,774 million, a reduction of only 12.5%. This is not true of the GIS, for which the major cause of expenditure increases has

been the growth in the real value of payments. If the real value of average GIS benefits had been held constant at their 1970 levels, total payments would have been $2,368 million in 1988, rather than $3,725 million, a reduction of 36%.

Why have real GIS payments grown so much and what are their component parts? Does the growth of GIS payments reflect an increasing incidence of poverty among the elderly or does it rather represent an increasing generosity on the part of the federal government? There are several ways of looking at these questions. The growth in the number of GIS beneficiaries has been only slightly higher than the growth in the number of OAS beneficiaries. Interestingly, though, the number of recipients receiving the full benefit has steadily declined, while the number receiving a partial benefit has grown to three times its 1970 number.

The GIS was actually viewed as a temporary measure when it was introduced. That was the period when the Canada Pension Plan (CPP) came into existence. The GIS was intended to help those who did not or could not participate in the CPP. As CPP participation increased, however, the need for the GIS was to diminish. Although the number of recipients of full benefits has declined as CPP participation has increased, the number of recipients of partial benefits has increased. One explanation for this is the nature of the tax back regime. Income other than OAS payments is taxed back at a rate of 50%. The point at which partial benefits cease to exist is when income is equal to two times the level of GIS maximum benefits. This cut off point grows with the GIS. The government has decided in the past that the GIS maximum should grow in real terms and it has used *ad hoc* increases to achieve this. (The GIS is also fully indexed to CPI changes.) This means that the cut off point has also grown in real terms. As a result a greater proportion of the elderly population has become eligible for partial GIS payments.

To put the discussion of OAS and GIS in perspective, we can look at their relative shares of GDP. In 1970, OAS payments accounted for 1.8% of GDP. This ratio fell to 1.6% and remained at that level until 1982 when it reverted to 1.8%, where it has stayed. Because OAS benefits have increased only slightly in real terms over this period, real GDP growth was able to offset the increase in the OAS eligible population. The pattern for the GIS is quite different. In 1970, GIS payments represented 0.3% of GDP. This ratio increased to 0.5% in 1971 and

remained at that level for ten years. In 1981 it increased to 0.6% of GDP and in 1985 was at 0.7%. GIS maximum benefits have increased substantially in real terms, and because of the nature of the tax back mechanism, the eligible population has also increased. Thus a program which was initially viewed as temporary has more than doubled in relation to the size of the economy.

2. The Seniors' Benefit

As the government seeks to control its spending in order to reduce the deficit, it has so far made only minor adjustments to its benefits package for the elderly. The 1996 budget announced the introduction of a new Seniors' Benefit that is to begin in 2001. It will be a targeted and tax-free benefit aimed at elderly families, and indexed fully to inflation. Eligibility and the size of benefit will be based upon family income. Once the new Seniors' Benefit comes into existence, the OAS, GIS, Age Credit and Pension Income Credit will disappear.

The existing system will remain in place for today's seniors, although they will have the option of transferring to the new system if that would be to their advantage. Those who reached age 60 by 31 December 1995, or who are married to a spouse who did so, may choose between the old and new system. Those who choose to remain in the old system will still lose the age and pension income credits. Although the federal government has promised that OAS and GIS payments will not be reduced, the existing system will be delivered, as of 2001, in an environment of less generous tax treatment for the elderly.

Reforming elderly benefits can have a major impact on the standard of living enjoyed by seniors. The government feels, however, that demographic changes make the existing system unsustainable. Consequently it is granting five years of advance warning, providing a transition period and grandfathering existing seniors' benefits. Any savings resulting from the reform will not be seen for many years. In 2001, savings of less than 1% of program costs are expected. Savings in 2030 are projected to be 10.7%.

As the new Seniors' Benefit is tax free, there will be a negative effect on provincial revenues as the personal income tax base declines with the disappearance of old age pensions.

3. Unemployment Insurance

Total Unemployment Insurance (UI) benefits are today in the neighbourhood of $13,500 million annually. In fiscal year (FY) 1970, these benefits totalled less than $550 million. A comparison of these dollar amounts over more than two decades suffers from the same problems that plague all such comparisons: changes in the relevant price index and scale of the economy distort the magnitude of the differences. Nevertheless, the growth in UI benefits is not an illusion. **In the late 1960s they equalled 0.56% of GDP, whereas since 1982 they have exceeded 2% of GDP. Today they are closer to 1.7% of GDP.** We cannot appeal to inflation or increases in the absolute numbers of unemployed to explain this growth.

The obvious variable to consider when explaining the ratio of UI benefits to GDP is the unemployment rate. But this alone is not responsible. The unemployment rate since 1982 has been 2.7 times the average rate of that of the late 1960s, but the ratio of UI benefits to GDP is 4 times higher. Something else has happened to make the unemployment insurance system as expensive as it is.

Two institutional changes help to explain the growth. In 1971 the system was significantly liberalized. This increased benefit levels and made them taxable; it loosened eligibility requirements; it increased both the duration of benefits and increased overall coverage. It is estimated here, that this institutional change increased the ratio of UI benefits to GDP by 0.56 percentage points for every level of the unemployment rate. In addition to this direct effect, the institutional change increased the cost of the UI program to the extent that it increased the rate of unemployment. Estimates of this UI-induced unemployment range from 0.4 to 1.9 percentage points.

In 1978, the unemployment insurance system was tightened up in light of dissatisfaction with some aspects of the 1971 reforms. It is apparent that these new changes were successful: even though the average unemployment rate increased after 1978, the ratio of UI benefits to GDP actually fell. It is estimated here, however, that the 1978 changes countered only about one-half of the 1971 changes. Thus the present system is still more generous than the one in existence prior to 1971.

The recent cost of the UI system is the result mostly of the high rates of unemployment that started with the recession, though they have since fallen. The benefit/GDP ratio varies approximately 0.5 percentage points for every 3 percentage point change in the unemployment rate. But the decline in unemployment has slowed down considerably and thus we should continue to see benefit/GDP ratios considerably higher than those of 1970.

What is clear, nevertheless, is the sensitivity of the size of the program to institutional change. Such change has a major and rapid effect on the size of the UI program. For example, implementing the recommendations of the Forget Commission could have the same effect on program cost as a three percentage point drop in the unemployment rate.

The federal government introduced Bill C-21 in June 1989 in an attempt to reduce the disincentive effects of unemployment insurance and to reduce federal expenditures in this field. This bill imposed stricter entrance requirements for UI benefits, reduced the duration of those benefits on average, and withdrew federal government financial contributions to this program. It is expected these proposed measures will save the government $1,900 million annually.

The Liberal government of Prime Minister Chrétien initiated unemployment insurance reform early in its mandate, looking to reduce program spending by close to $1,000 million per year. Legislation for the new Employment Insurance Program is now wending its way through Parliament, reducing maximum benefits, reducing benefits somewhat to repeat users and generally tightening up the system.

4. Family Allowances/Child Tax Benefits.

The historical pattern of family allowance expenditures is relevant to this discussion for a number of reasons. In the first place, family allowances were an important component of federal spending on social development. By 1991, net family allowance payments amounted to about $2,800 million and were delivered to over 3.7 million families. But this program is also interesting in that it demonstrates how expenditure patterns can be totally misleading. Changes in the design of the program since 1970 make it difficult to discuss trends. The program started out as a modest non-taxable benefit available without regard to income. It then became a taxable

benefit in 1974 and was substantially increased. In 1979, the level was reduced and a Child Tax Credit (CTC) introduced.

The number of children for whom family allowances are delivered, peaked in 1975 at 7.3 million.

In 1970, family allowance payments amounted to 0.6% of GDP. This increased to 1.2% in 1974 as a result of the big increase in gross benefits per child. The ratio of payments to GDP declined to 0.9% over the next four years and then further declined to 0.6%. This was mostly the result of the decrease in the number of eligible children and the 1979 reduction when the CTC was introduced.

The Child Tax Credit was technically considered to be a tax expenditure and as such did not show up in expenditure or revenue figures. But such an exclusion is purely arbitrary and the CTC could just as easily have been considered as an expenditure with "tax back" provisions like the GIS. If we treat it as such and combine it with the family allowance, the pattern of child expenditures is as follows: from 0.6% of GDP in 1970, these expenditures increased to 1.2% in the mid-1970s when the number of children peaked; the ratio then declined slightly, only to jump up again to 1.3% with the introduction of the CTC; finally, it fell to its 1990s level of 0.9% of GDP as a consequence of a further decline in the client population.

The April 1989 federal budget introduced a benefit reduction scheme which applied to Old Age Pensions and Family Allowance Payments, taxing both through the personal income tax system. Benefits were reduced by $0.15 for every dollar of individual income in excess of $50,000. The Family Allowance Program no longer exists, having been replaced by the Child Tax Benefit as of 1 January 1993. Transfers to persons, which are now near record levels, would have been even higher in the absence of this reform. **The 1996 budget will double the working income supplement in two stages, to $1,000.**

C. Debt Charges

The discussion above has dealt with various program expenditures of the federal government. A large and growing component of government spending, however, is interest

charges on accumulated government debt. In 1970 these charges amounted to $1,800 million whereas they could reach $40,000 million this fiscal year. As a percentage of GDP, they have more than doubled, to almost 6%.

It is popular to blame this component of expenditure on monetary policy rather than fiscal policy, citing the role of high real interest rates since 1982-83. Debt charges could be reduced substantially by a policy designed to reduce prevailing interest rates, it is argued. For example, at the time of the release of the 1988 Main Estimates, it was claimed that a one percentage point drop in interest rates could reduce debt payments by $1.4 billion.

It is true that real interest rates are today much higher than they were in the 1970s. But during that period we experienced accelerating inflation which left *ex post* real interest rates often at very low, even negative levels. The desirability of repeating such an experience is not at all obvious. It is not at all clear that the Bank of Canada could reduce real interest rates through a policy of monetary expansion. Nor is it obvious that all of today's high debt charges can be blamed solely on high interest rates. There is another important variable to consider; namely, the stock of debt to which these interest charges are applied.

In the first half of the 1970s, debt charges averaged 2.2% of GDP. This was associated with a falling debt to GDP ratio and low, often negative, real interest rates. After 1976, debt charges rose steadily to over 4% of GDP even though real interest rates continued to be relatively low. This was because the stock of debt was growing. The debt to GDP ratio grew over this period as the federal government started to run considerable deficits.

Starting in 1984, debt charges exceeded 5% of GDP. During this time, while the stock of debt grew rapidly, real interest rates were extremely high by recent standards. It is this factor which has led some analysts to argue that high debt charges are a matter for monetary policy.

To test this assertion we estimated the effect on debt charges of a 3% real interest rate, starting in fiscal year 1982. Although a 3% real rate is still high by the standards of the 1970s, when real rates of interest were unusually low, it is compatible with the long run interest rate experienced in Canada.

The average ratio of debt charges to GDP since fiscal 1982 has been 4.8%. With a 3% real interest rate this ratio would have fallen to 3.64% on average. The debt to GDP ratio would have fallen marginally as well, from 59.47% to 57.4% at the end of 1986-87. The average ratio of debt charges to GDP would, however, still have been significantly higher than anything experienced in the 1970s. The impact of such a lowering of interest rates on the size of the debt and corresponding debt charges has been overestimated. That action limits the ratio of gross debt charges to gross public debt, as published by the Department of Finance, to 3% in real terms. But a policy which lowered interest rates today would affect only new borrowing. It would be several years before a sustained drop in interest rates affected the entire stock of outstanding debt.

D. Recent Federal Budgets and the December 1992 Economic Statement

On 20 February 1990, the Hon. Michael H. Wilson tabled his sixth budget. The highlight of this budget was an expenditure control plan, designed to reduce total spending by $6,111 million over two years and $16,689 million over the next five years. This plan contains four elements. First, a number of programs, most notably Canada Assistance Plan payments to Ontario, British Columbia and Alberta, will grow by no more than 5% per annum over the next two years. Second, Established Programs Financing were frozen on a per capita basis for two years. Third, some programs were reduced, including spending on social housing, Health and Welfare and Secretary of State grants. Finally, some programs were eliminated - these include the Canadian Exploration Incentives Program, the OSLO oil sands project and the Polar 8 Icebreaker.

These measures were expected to reduce program spending to 14.2% of GDP by 1994-95. Today they stand at 16% of GDP.

The main thrust of the 1991 budget was to extend by three years the expenditure control plan introduced the year earlier. It also contained, as part of this plan, a wage restraint program for the Public Service of Canada as well as legislated limits on program spending.

The program spending restraint legislation set out in the budget is a hybrid of the American Gramm-Rudman deficit control limits and sunset legislation used at the American state government level to control the growth of government programs. The budgetary proposal limits

total program spending from 1991-92 to 1995-96 to $615,300 million. The limits for each year will grow by an average of 3% per year. It is the intent of this measure to limit overall spending, so that any excess in one year will not be added to the expenditure base but must be offset in other years.

The 1992 budget extended even further the Expenditure Control Plan as well as cutting $1,000 million from 1992 spending.

The poor performance of the Canadian economy has put further pressure on the federal deficit, mainly through revenue reductions but also because of some program spending increases. In response to these developments, the government took further initiatives to curb and control the cost of government operations by $ 3,600 million over a two-year period. Some of these new measures included a 10% reduction in most grants and subsidies in each of the next two years, a further two-year wage freeze for public servants and politicians, and a 3% reduction in operating budgets. In addition, the UI benefit rate for new beneficiaries was reduced from 60% of insurable wages to 57%. Those who quit their jobs without just cause, or who are fired, lost eligibility for UI.

E. The 1993 Federal Budget

This budget has added a few new elements of spending control to those announced in past budgets and in the economic statement. The new measures though, are small in comparison with earlier moves.

Grants and contributions, which were cut by 10% for two years, will now be cut by 20% after 1996-97. Reductions to regional development programs are also being extended and some federal-provincial development agreements will not be renewed. Where previous restraint measures allowed for future increases, those increases are now limited to 1.5% per year, the expected rate of inflation. This applies to defence spending, international assistance and the funding of university research councils.

CMHC funding for social housing is to be frozen at $2,000 million per year, while funding for the CBC and VIA Rail will be cut by $100 million per year after 1995-96. An

additional $300 million is to be taken from operating budgets in 1993-94 and 1994-95, with larger cuts thereafter. All in all, though, these additional cuts will have their greatest impact several years in the future.

Despite all these cuts, we have government operations increasing from $17,150 million in 1991-92 to $20,300 million in 1993-94, an 18.4% increase over two years.

Program spending will increase, according to this budget, by 1.7% per year from 1993-94 to 1997-98. This is just slightly above the rate of inflation. In the short term, however, the growth in program spending is higher, masked by restructuring of child benefits. Program spending this year is to be 2.8% higher than in 1992-93. Next year's growth will be almost as high, at 2.6%

This budget meets the requirements of the *Spending Control Act*. In fact, cumulative spending to 1995-96 is expected to be $8,500 million less than allowable limits and the government proposes that this underspending be incorporated in new, lower limits. These spending limits have been adjusted to account for the restructuring of federal programs which moved some obligations out of the realm of program spending.

F. The 1994 Federal Budget

This budget is projecting stable program spending to 1995-96. Any growth in total spending will be the result of higher debt servicing costs.

This apparent stability in program spending is due to the reforms put in place with respect to the system of child benefits. Without these reforms, expenditures would have grown; instead, tax revenue will decline.

G. Finance Committee Report

In December 1994, the House of Commons Standing Committee on Finance tabled its report on its pre-budget consultations. Presenting his economic and fiscal update in October, the Minister of Finance noted that higher than anticipated interest rates were forcing deficit forecasts

upward. The Minister said that an additional $9,400 million in spending cuts and/or revenue increases would be needed to keep the deficit on track.

The Finance Committee Report tackled this problem by recommending $9,900 million in deficit-cutting measures over a two-year period. The Committee's recommendations offer an additional $500-million cushion to the federal government's projected needs, although the continuing increase in interest rates may make even this gesture insufficient.

The Committee chose to concentrate on spending cuts rather than tax increases. The $8,749 million in expenditure reductions are to be achieved via a 12% reduction in the cost of government operations, an 11% cut in grants to Crown corporations, a 36% cut in business subsidies, a 6% reduction in defence spending, and a 10% cut in international assistance. These reductions are to be phased in over two years.

The expenditure reductions recommended by the Committee are meant to be over and above any previously announced reductions. The $8,749 million cited includes $3,400 million in savings expected from the review of social security programs, in addition to the measures factored into the deficit base in the 1994 budget.

H. The 1995 Federal Budget

From 1990 to 1993, federal spending grew at a faster pace than revenues. This is now changing. After 1994-95, program spending is expected to decline every year; by 1997 it will be $12,000 million less than in 1993-94, when it totalled $120,000 million. As a proportion of GDP, program spending including restructuring charges will decline from 16.9% to 13.1%. But, while program spending is declining, public debt charges are slated to increase substantially. By 1996-97, they are expected to exceed $50,000 million (6.2% of GDP), compared to $38,000 million (5.3% of GDP) in 1993-94.

The government is able to control spending on account of a major review and reduction in program expenditures and government operating costs that will lead to a 45,000 person decline in federal employment. While approximately 6,000 of the positions are expected to be transferred to the private sector, the remaining positions will disappear.

As part of these cuts, business subsidies are to be reduced by 60% over three years. Certain agricultural subsidies are to be reduced or eliminated altogether. Program review will result, for those departments that have been reviewed, in spending levels in 1997-98 almost $10,000 million less than in 1994-95. This represents a 19% decrease.

In addition, the government is combining the Canada Assistance Plan and Established Programs Financing transfers into one block grant, starting in 1996-97. This Canada Social Transfer will be based on a new formula that will result in a total of $4,700 million in reduced transfers for 1996-97 and 1997-98. Provinces will have more say as to how they spend these funds while federal transfers will no longer be linked to provincial spending decisions.

The government's spending projections also factor in a reform of unemployment insurance, which should save at least $700 million in 1996-97. Some small changes have been made to the Old Age Security system with the promise of much more to come following a review by the Minister of Human Resources Development.

The 1995 federal budget announces $25,300 million in cumulative expenditure cuts over a three-year period ending in 1997-98, with $17,000 million due to program review. Only 16% of these cuts, will however, take place in the first year.

I. The 1996 Federal Budget

This budget, unlike the 1995 budget, does not introduce significant spending cuts. It does, however, ensure that program spending will continue to fall, to $105,500 million in 1998-99. This is in contrast to program spending of $118,700 million in 1994-95.

The budget extends Program Review, saving an additional $1,900 million in 1998-99. Some of the major new announcements in the budget include a further 3.5% reduction in departmental budgets in 1998-99, a phasing out of the dairy subsidy, an 18% reduction in the postal subsidy, lower spending on VIA Rail and AECL, and more cuts to defence. Some of these savings are re-allocated to other areas of greater priority.

PARLIAMENTARY ACTION

In a very real sense, the history of government expenditures is the result of parliamentary action in one form or another. Approximately once a year, the Minister of Finance presents a budget to Parliament in which the government's future spending and taxation plans are outlined. In addition, almost every bill passed in Parliament has some impact on government expenditures.

CHRONOLOGY

June 1971 - The UI system was substantially expanded and liberalized with the passage of Bill C-229.

January 1974 - Family allowance payment was increased to $20 per month per child and began to be treated as taxable income. The monthly payment also became subject to indexation.

1977 - Bill C-27 was introduced and passed in 1977 to tighten up the liberalized UI system. It increased eligibility requirements and reduced maximum weeks of benefits for a wide range of UI recipients.

1978 - Child Tax Credit was introduced. Maximum benefit was set at $200 per eligible child.

1979 - Family allowance benefits were reduced by about 22% starting in January.

1983 and 1984 - Indexation factors for government expenditures were limited to 6% and 5% respectively.

May 1985 - The federal budget proposed limiting indexation to CPI changes in excess of 3 percentage points.

November 1986 - The Commission of Inquiry on Unemployment Insurance (C.E. Forget, Chairman) released its Report calling for major changes to the UI system in order to return the program to its insurance function.

October 1994 - The Minister of Finance, the Honourable Paul Martin, published the Economic and Fiscal Update.

December 1994 - The House of Commons Standing Committee on Finance tabled its report "Confronting Canada's Deficit Crisis."

SELECTED BUDGETS AND PROJECTED EXPENDITURES

Hon. D.S. Macdonald, May 1976, $39,400 million for 1976-77.
Hon. J. Chrétien, April 1978, $46,900 million for 1978-79.
Hon. J. Crosbie, December 1979, $51,950 million for 1979-80.
Hon. A.J. MacEachen, June 1982, $78,100 million for 1982-83.
Hon. M. Lalonde, February 1984, $96,926 million for 1984-85.
Hon. M. Wilson, February 1986, $116,740 million for 1986-87.
Hon. M. Wilson, February 1987, $122,550 million for 1987-88.
Hon. M. Wilson, February 1988, $132,300 million for 1988-89.
Hon. M. Wilson, April 1989, $142,900 million for 1989-90.
Hon. M. Wilson, February 1990, $147,775 million for 1990-91.
Hon. M. Wilson, February 1991, $159,000 million for 1991-92.
Hon. D. Mazankowski, February 1992, $159,600 million for 1992-93.
Hon. D. Mazankowski, April 1993, $159,500 million for 1993-94.
Hon. P. Martin, February 1994, $163,600 million for 1994-95.
Hon. P. Martin, February 1995, $163,500 million for 1995-96.
Hon. P. Martin, March 1996, $156,800 million for 1996-97.

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